BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

MARC SPITZER-Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR AN ORDER OR ORDERS AUTHORIZING IT TO ISSUE, INCUR, OR ASSUME EVIDENCES OF LONG-TERM INDEBTEDNESS; TO ACQUIRE A FINANCIAL INTEREST OR INTERESTS IN AN AFFILIATE; TO LEND MONEY TO AN AFFILIATE OR AFFILIATES; AND TO GUARANTEE THE OBLIGATIONS OF AN AFFILIATE OR AFFILIATES	DOCKET NO. E-01345A-02-0707

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ARIZONA PUBLIC SERVICE COMPANY'S CLOSING POST-HEARING BRIEF

Arizona Public Service Company ("APS" or "Company") hereby submits its Closing Post-Hearing Brief in support of the Company's Application for Financing Authority ("Application").

I. INTRODUCTION

The opening briefs submitted in this proceeding merely underscore what the evidence already shows. Approving the APS Application, subject to the Utilities Division Staff ("Staff") conditions as discussed by APS witness Barbara Gomez, is in the public interest and consistent with the requirements of A.R.S. § 40-301, *et seq.* APS customers are not placed at risk, and indeed receive substantial benefits if the Application is granted. Conversely, denying the Application forgoes the protection of the Staff conditions and will precipitate a liquidity crisis at PWCC that likely will adversely affect APS customers

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both now and in the future with no discernable benefit in return. It would also negate an agreement between Staff and the Company to severely limit any litigation over the Track A decision. Under such circumstances, APS believes the two choices presented the Arizona Corporation Commission ("Commission") dictate but one logical action—approval of the Company's financing request and authorization for an inter-company loan of the proceeds as recommended by Staff and APS.

II. SUMMARY OF APS REPLY

Panda Gila River, L.P. ("Panda/TECO"), asks the Commission to ignore not only all the testimony and evidence presented by APS in this proceeding, but also that of its own Staff. Panda/TECO further claims to represent only APS ratepayers' interests, as well as those of APS debt holders, although the legitimate representatives of both these groups strongly support the Company's Application. (*See* the Initial Briefs of Residential Utility Consumer Office ["RUCO"] and the Arizona Utilities Investors Association ["AUIA"].) What we are left with is barely more than the bald assertion that Panda/TECO and its witness are right and everyone else in this proceeding is wrong. Panda/TECO's only witness was completely discredited by her former employer on the only subject about which she could claim any expertise, namely the likely reaction of Moody's to a granting of the Application. The remainder of Panda/TECO's "case" alternated between "over-the-top" hyperbole having no record support and blatant distortions of the actual record. And Panda/TECO offers no practical solution to what all recognize is a serious liquidity problem resulting from the isolation of Pinnacle West Energy Corporation ("PWEC") generating assets from those of APS. (*See* Staff Opening Brief at 3.) Panda/TECO's belated offer of a guarantee provides none of the benefits of the Staff's conditions and is so conditioned as to be unmarketable under current financial market conditions.

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Sempra Energy Resources, Inc., and Southwestern Power Group II, LLC ("Sempra/Southwestern"), employ an argument against the Company's Application based on hyper-technical and flawed statutory interpretation. It is an argument that ignores the reality of the present situation and the Commission's obligation to protect both APS customers and investors in its quest to serve the public interest. Not only would Sempra/Southwestern leave this Commission powerless either to prevent harm to APS and its customers or to obtain the clear benefits of Staff's conditions, it would have the Commission roll back the clock on modern corporate law principles by at least 25 years. Sempra/Southwestern's arguments have no merit under current Arizona law.

Although both Staff and RUCO support the conditional grant of the Company's request, the Staff Brief makes assertions concerning APS, Pinnacle West Capital Corporation ("PWCC") and PWEC that may confuse the record and thus require a response. And RUCO's proposal to condition the financing on the transfer of PWEC's assets to APS would embroil this proceeding in precisely the sort of controversy the Company attempted to avoid in its original Application and thus would eventually be self-defeating. It is also unnecessary given the clearly articulated intent of APS to seek rate base treatment of these assets, which would necessarily mean their transfer to APS, in the Company's next general rate proceeding.

Intervenors Reliant Energy Resources ("Reliant") and Arizonans for Electric Choice and Competition ("AECC") have raised concerns in their initial briefs that are not germane to the Application and need not be addressed by the Commission. No party, including APS, has suggested that the proposed financing will affect either the conduct or results of the also pending Track B proceeding.[1] Likewise, the Principles for Resolution of

[1] The Recommended Opinion and Order on Track B was issued on January 29, 2003. Even the most cursory review of such Recommendation reveals that the proposed APS financing was not a consideration in the Administrative Law Judge's consideration of that matter.

Track A Issues is neither binding on AECC nor does it limit the Commission's discretion to grant or deny any specific relief in the Company's 2003-2004 rate case.

III. REPLY TO PANDA/TECO

A. Panda/TECO Has Ignored Or Distorted The Record

Panda/TECO's Initial Post-Hearing Brief is filled with one unsupported allegation after another. It questions Staff witness John Thornton's credibility by suggesting he would testify contrary to his "true" feelings on the Application and then distorts his as well as the Company's actual testimony in this proceeding. Panda/TECO ignores (but does not refute) the asserted benefits to APS customers of granting the Application, especially with Staff's proposed conditions.

1. Panda/TECO Assertions Having no Record Support

In its Introduction, Panda/TECO claims that granting the Company's Financing Application would, amongst a series of other unfounded assertions, result in "stifling the Arizona competitive wholesale market" and "has everything to do with preserving wholesale competition [emphasis supplied]." (Panda/TECO Initial Brief at 1.) Panda/TECO further claims that "rate-basing the PWEC assets would decimate wholesale competition in Arizona." (*Id.* at 28-29.) Even assuming that the rate-basing of the PWEC assets was an issue in this proceeding, which it is not, it is hard to understand how committing 1700 MW of PWEC generation to APS customers could "decimate wholesale competition in Arizona." APS' requirements are but a tiny fragment of the vibrant western wholesale market. And the removal from a market of equal amounts of supply and demand would leave the remaining market unaffected in any event. Panda/TECO's statement is all the more puzzling because apparently a similar commitment of Panda/TECO generation (or for that matter, any other supplier's generation) to APS

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would not "decimate wholesale competition in Arizona." (*See* Panda TECO Initial Brief at 3.)

Similarly, Panda/TECO contends that a "viable competitive market" is at risk. (Panda/TECO Initial Brief at 20.) Panda/TECO cites absolutely no record evidence to support any of these examples of imaginative hyperbole, which defy both economic theory and plain common sense.

Panda/TECO has never, in the many proceedings it has participated in before this Commission, presented an employee witness (or any witness, for that matter) that could be questioned under oath about its Arizona project. Thus, it is not surprising that Panda/TECO had no evidence to support its claims of building facilities in anticipation of serving APS or in reliance upon the Commission's Electric Competition Rules. (Panda/TECO Initial Brief at 3 and 21.)[2] During the discovery phase of Docket No. E-01345A-01-00822, APS asked each of the merchants to provide any evidence that indicated that serving APS was even one of many reasons for locating their facilities in Arizona. No such evidence was or has since been provided. (J. Davis Rebuttal Test., Docket. No. E-01345A-01-0822, *et al.*, at 32-34 [April 22, 2002].) This is because no such evidence exists. (*See* Tr. vol. IV at 886 [M. Diaz-Cortez].)

At page 19 of its Brief, Panda/TECO claims:

> There is likewise no evidence or, for that matter, any reason to believe that APS could not have built the PWEC facilities and transferred the merchant units eventually to PWEC along with APS' other generating facilities, as was envisioned in the 1999 APS Settlement.

If this is intended as a criticism, it is a strange one. It implies that had APS built the PWEC plants at APS, using APS credit to finance them from the beginning pursuant to

[2] Panda did introduce an obscure stock analyst's report from a Gerard Klauser Mattison to support this assertion. The report identifies no source or other supporting data for its observation about the motivation of independent power producers in building plants in Arizona or any particular expertise on the matter. It certainly does not reflect the reality of the situation, which is that the APS load not served by existing assets could not support Panda/TECO even if it were the only potential bidder for such load.

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either the Company's existing or with new debt authority, Panda/TECO would have had no objection. And yet such a course of action would have resulted in precisely what it now claims would "decimate" the competitive wholesale market—APS ownership of the PWEC assets—and would not have avoided the need for APS to take on additional debt. (*See* B. Gomez Rebuttal Test. at 11; Tr. vol. IV at 1011, line 16 – 1012, line 16.) In fact, there is no evidence that APS would have been permitted to construct the PWEC assets itself, and any attempt to do so would have flown in the face of the Commission's policy requiring generation divestiture—a policy in place over a year prior to the 1999 APS Settlement. And the only evidence of record supports the Company's assertion that the combination of the Commission's Electric Competition Rules and the APS Code of Conduct, which categorized generation as a "Competitive Activity,"[3] would have prohibited such new construction. (Tr. vol. II at 399-402, 477-480 [J. Davis]; Tr. vol. III at 520-522 [J. Davis].)

2. Panda/TECO's Misrepresentation of Staff's Position

At page 6 of its Brief, Panda/TECO claims that Staff witness John Thornton "noted in his direct testimony [that] APS's case for its financing proposal under A.R.S. § 40-301

[3] Generation is clearly a "Competitive Service" even when part of Standard Offer. *See* A.A.C R14-2-1601(7) and (29). Section X (B) of the APS Code of Conduct prohibits APS from engaging in "Interim Competitive Activities," which in turn is defined as "Competitive Services, exclusive of those set forth in A.A.C. R14-2-1615 (B) [which the Code of Conduct considers "Permitted Competitive Activities"], that APS may lawfully provide until December 31, 2002." Although Section X (B) could be read literally as immediately prohibiting the Company's continued ownership of its existing generation, the express extension of the divestiture date in Decision No. 61973 to December 31, 2002 contradicts such a literal reading. However, it was the clear understanding at the time the APS Code of Conduct was adopted that Section X (B) did prohibit APS from building or acquiring new generation except in conformance with A.A.C. R14-2-1606 (B). Despite these Commission regulations and the provisions of the APS Code of Conduct, Counsel for Panda/TECO appears to take the position that generation used to serve the Company's retail load would not be considered a "Competitive Activity." (See Panda/TECO Initial Brief at 9.) Because all of APS' (and TEP's, for that matter) existing and future generation is and would be used to serve APS retail load, such a reading would effectively negate the Commission's divestiture requirement in A.A.C. R14-2-1615 (by making such divestiture unnecessary) and would have rendered A.A.C. R14-2-1606(B) similarly meaningless.

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is weak at best and 'a step backward for public policy . . .'." In fact, nowhere in Mr. Thornton's direct testimony or during his cross-examination did he ever characterize the Company's case as "weak at best." And the second part of Panda/TECO's assertion (which at least contains part of a statement that Mr. Thornton actually did make) was explained and qualified by Mr. Thornton within the balance of the very sentence that was only partially quoted by Panda/TECO. Thus, under the circumstances of this case and with the provisions proposed by Mr. Thornton, the statement became wholly inapplicable to the Company's Application. (*See* J. Thornton Test. at 6.)

Panda/TECO then indulges in the further speculation that Mr. Thornton "was very uncomfortable with the evidence APS presented to meet its burden of proof." (Panda/TECO Initial Brief at 7.) Staff's Initial Brief in this matter certainly reflects no such discomfort. Neither did Mr. Thornton during his cross-examination by several of the merchant plant intervenors, as is evident by the failure of Panda/TECO to provide any record citation supporting such alleged discomfort or even to cite the remainder of Mr. Thornton's answer to Panda/TECO interrogation:

> It took a number of other conditions surrounding this docket to enable [Staff] to craft conditions to hold APS harmless and to provide these benefits. So on the whole, with the weights and balances, we were able to find [the Application] in the public interest. [Emphasis added.]

(Tr. vol. IV at 945, lines 8-13 [J. Thornton].) Later, Mr. Thornton testified that "it's clear to Staff that this [Application] is in the public interest." (Tr. vol. IV at 992, lines 18-20 [J. Thornton].)

3. Panda/TECO's Failure to Acknowledge the Benefits from Granting the Application

At page 19 of its Brief, Panda/TECO allege that "APS's eight 'benefits' are either unsupported by the evidence or achievable through a PWCC refinancing." Significantly, this claim does not extend to the benefits cited by Mr. Thornton in support of Staff's position on the Application, none of which are realized if the Company's Application is

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denied. (*See* Tr. vol. IV at 990-992 [J. Thornton].) Panda/TECO also chooses to ignore all the record evidence cited by APS in its Initial Brief at Section V. APS will not repeat its arguments from that Initial Brief. Instead, APS asks the ALJ to consider whether if, as argued by Panda/TECO, it were reasonably possible for PWCC to refinance the Bridge Debt without a loan from APS, then why would APS ever agree to the strict Staff conditions attached to the financing? These conditions include the loss of up to some $13 million per year (not including accrued return), a dividend limitation, a four-year respite in the goal of achieving permanent financing for the PWEC units, and a "hold-harmless" promise to APS customers. And why would APS agree to voluntarily surrender the bulk of its legal claims arising from the Track A order? The obvious answer is that APS would not. Actions speak volumes, and the Company's actions provide the most tangible and credible support for its position in this proceeding.

4. Panda/TECO has misrepresented the APS request and its evidence in support of that request

Panda/TECO alleges that APS requested a waiver of the Commission's Affiliate Rules. (Panda/TECO Initial Brief at 5.) A review of the Company's Application reveals no such request even though virtually every other covered public service corporation has received at least one waiver of the Affiliate Rules. Rather, the Company asked for Commission approval of the proposed transaction as is specifically called for under the Affiliates Rules. (*See* A.A.C. R14-2-804.) Moreover, the purpose of the Affiliate Rules, which APS agrees is to protect ratepayers (and not Panda/TECO), is furthered by the Application because it protects APS customers from higher capital costs, provides additional benefits in the form of the Staff conditions, and eliminates significant litigation exposure from the Track A decision through the Principles for Resolution.

"APS introduced *no* written evidence that PWCC would be downgraded if it refinanced or renegotiated the bridge debt at the holding company level, nor any evidence

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that such a refinancing or renegotiation is impossible." (Panda/TECO Initial Brief at 11.) This statement is flatly contradicted by the sworn written testimony of the Company's two experts—experts whose familiarity with both PWCC and the capital markets dwarf that of Panda/TECO's witness—as well as the prepared testimony of both Staff and RUCO experts, and lastly by published written statements from each of the three major credit agencies. (*See* APS Opening Brief at Section IV.A.). This documentary evidence was apparently sufficient for Staff to conclude that: ". . .significant evidence nonetheless supports the conclusion that PWCC is at risk for credit downgrades. As a consequence, APS faces a similar risk." (Staff Initial Brief at 4.) Similarly, "the only way to stave off downgrades [of PWCC] by Moody's and Fitch is to refinance the bridge debt at APS." (RUCO Initial Brief at 4.)

"There was no serious rebuttal of Ms. Abbott's analysis [that PWCC could refinance the Bridge Debt with credit metrics within the BBB range]." (Panda/TECO Brief at 11.) This is not particularly surprising because no such analysis was ever presented to rebut. "Nor does her [Ms. Abbott's] testimony include any analysis of PWCC's resulting credit matrix [sic] if it were to refinance the debt." (Staff Initial Brief at 3.) Even if Ms. Abbott had presented an analysis of PWCC credit metrics to support her conclusion as alleged by Panda/TECO, it would not change the written agency reports to the contrary. Ms. Abbott's predictions concerning the reaction of rating agencies if the Application were to be denied should not be afforded the slightest weight in view of Moody's December 30th repudiation of the analysis she actually did present of the expected impact on APS of granting the Application.

"Finally, Ms. Abbott's testimony is supported by Ms.Gomez' and Mr. Davis' testimony that PWCC could 'raise' $300 million over the next year based on their [sic] own credit to complete the Silverhawk facility in Nevada." (Panda/TECO Initial Brief at 12.) APS agrees that this circumstance would have supported Ms. Abbott's testimony if

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only Ms. Gomez and Mr. Davis had actually testified as indicated by Panda/TECO and, more importantly, if it were true. In point of fact, they did not, and it is not. That is because there is simply not any additional $300 million to raise. By the time this matter is resolved, PWEC will already have spent over $300 million on Silverhawk, with the balance of the plant's estimated cost of completion to be reimbursed by the Southern Nevada Water Authority upon completion, and not from new PWCC financing. (Tr. vol. V at 1053-1054 [J. Davis].)

APS could provide similar examples from virtually every page of Panda/TECO's Initial Brief, but believes that it has made the point. Panda/TECO has attempted to obscure the fact that its recommendations lack evidentiary basis, provide no protection of or benefits to APS customers, and do nothing but further its own Track B agenda of negotiation by litigation.

B. APS Should Not Be Limited to Issuing a Guarantee of PWCC or PWEC Debt

After more than 20 pages arguing that APS' Application should be denied in its entirety, Panda/TECO implicitly acknowledge that it would be appropriate for the Commission to approve the Application. And during the hearing on the Application, Panda/TECO's legal counsel stated quite clearly that if APS would simply agree to a guarantee, Panda/TECO would support the Application. (Tr. vol. III at 748 [M. Engleman].) Panda/TECO now argues, however, that the Commission should limit APS' authority to that of guaranteeing PWEC's debt. In doing so, Panda/TECO attempts to support such restriction through a combination of unsupported allegations and misconstruction of the record.[4] When the evidence is examined in its entirety, it is clear

[4] Panda/TECO further implies in a footnote that the Commission should instead require PWCC to guarantee the debt of PWEC by asserting that APS presented no evidence to the contrary. (Panda/TECO Initial Brief at 22, fn. 8.) Panda/TECO's assertion completely ignores the testimony by Art Tildesley that PWCC would not be able to refinance the debt. (Tr. vol. II at 352-354, 360-62 [A. Tildesley].) Because investors and rating agencies would view a guarantor as taking on the debt in question, a PWCC guarantee of PWEC debt is functionally equivalent to PWCC taking on the debt itself. Moreover, PWCC already

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that the Application should be approved and that the loan, with the basic conditions proposed by Staff, is the appropriate financing method to be adopted by the Commission.

1. Timing of the Anticipated Commission Decision Supports Approval of the Loan with Staff's Proposed Conditions.

As APS explained in its Initial Brief, APS has requested the authority to issue a direct loan to PWCC or PWEC, guarantee the debt of PWCC or PWEC, or both. APS, which filed the Application to address the "serious and unique financial harm" faced by APS, PWCC and PWEC as a result of the decision to preclude transfer of the APS generation assets to PWEC, sought the flexibility in the Application to pursue either approach, depending on how the financial market developed. APS also specifically requested that the Commission address the Application by December 2002 because of the length of time it would take to implement either the loan or guarantee. (Application at 6, fn. 7, and at 15, ¶ 35.)

In arguing that APS should be limited to issuing a guarantee, Panda/TECO ignores that the timing of implementing a financing option is inextricably intertwined with the complexity of implementing that option. As APS explained in its Initial Brief, because the Commission is not expected to address the Application before early March, APS now is limited (if forced to choose one option over the other) to pursuing the loan in order to implement the financing plan in time. (APS Initial Brief at 25.) And timing becomes particularly critical because of the additional complexity that arises if a guarantee is instead required. In addition to the extra documentation that accompanies a guarantee (Tr. vol. II at 294 [B. Gomez]), PWEC is also required to issue debt instruments. If PWEC wishes a public offering of that debt, PWEC would be required to register the debt with the SEC as an initial public offering. A review by the SEC easily could take more than

stands behind PWEC, and thus, a PWCC guarantee also would be of little incremental value and have a very high probability of failure.

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two months. (Tr. vol. IV at 987-988 [J. Thornton]; Staff Initial Brief at 6.) While it is true that APS was aware of the complexity of obtaining a guarantee when it initially filed its Application (Tr. vol. II at 302 [B. Gomez]), that complexity did not present a significant concern at the time of the filing because APS also requested Commission action by December 2002. And, of course, APS was also unaware of the Staff position at that time.

Panda/TECO, which presented no evidence of its own relating to the complexity of implementing a guarantee,[5] glosses over the unchallenged testimony specifically addressing the added complexity of such an approach. First, both Ms. Gomez and Mr. Tildesley consistently noted the increased complexity of a guarantee as compared to a loan. (*See, e.g.,* B. Gomez Direct Test. at 14-15; A. Tildesley Direct Test. at 9; Tr. vol. II at 292-293, 302 [B. Gomez]; Tr. vol. II at 366 [A. Tildesley].) Staff Witness John Thornton also agreed that a guarantee would be more complex and, therefore, would take longer to implement. (Tr. vol. IV at 933-934, 987-988 [J. Thornton].) Finally, the testimony clearly showed that certain of Staff's suggested conditions could not be implemented as proposed if APS were ordered to issue a guarantee instead of a loan. (Tr. vol. II at 295 [B. Gomez].)

2. Granting Approval of the Loan will not Prejudge the Outcome of APS' Stated Intent to Request Approval to Rate-Base the PWEC Assets

Although agreeing that the Commission need not decide in this proceeding whether the PWEC assets should be rate-based, Panda/TECO goes to great lengths to imply otherwise, spending much of its Brief arguing its "case" against rate-basing.[6] It further contends that Commission approval of a loan somehow will prejudge the outcome of any

[5] While Panda/TECO indicates that their witness, Ms. Abbott, testified that a guarantee would not be more complex than a loan, Ms. Abbott made no such statement in her testimony.

[6] Just as rate-basing of the PWEC assets is not at issue in this proceeding, the Commission need not resolve the collateral issue of why the PWEC assets were built in the first place. Staff witness Thornton specifically testified that Staff's recommendations were not premised or dependent in any way on this issue. (Tr. vol. IV at 996.)

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future request by APS to put the PWEC assets into rate-base and, therefore, will itself "decimate" wholesale competition. (Panda/TECO Initial Brief at 26-32.) In fact, Panda/TECO makes the argument that APS prefers a loan solely because a loan would be easier to undo than a guarantee if the Commission eventually approves rate-basing of the PWEC assets. Panda/TECO rests that unfounded conclusion on a few selected statements by APS witness Gomez culled from her extensive testimony in response to lengthy cross-examination during the hearing, while failing to acknowledge the rest of the testimony. Indeed, Panda/TECO simply ignores that it was Staff that proposed APS be given a security interest in the PWEC assets as a condition of the loan. Furthermore, APS witnesses testified that a guarantee would not stop APS from rate-basing the PWEC assets should the Commission approve a subsequent request by APS to do so.

APS has repeatedly acknowledged that the Commission's granting of its Application will not prejudge the outcome of APS' stated intent to ask the Commission for approval to rate-base the PWEC reliability assets. (Application at 4; APS Initial Brief at 17-18; Tr. vol. II at 415-416 [J. Davis].) First, APS' Application did not initially request that APS have a security interest in the PWEC assets, but Staff proposed such a condition to protect APS and, therefore, its customers. (Staff's Initial Brief at 5; Tr. vol. IV at 935 [J. Thornton].) And in response to repeated questioning by counsel for the merchant intervenors, APS witness Barbara Gomez indicated only that a loan would be somewhat easier to undo if the Commission ultimately agreed to rate-base the assets. (Tr. vol. II at 293-295 [B. Gomez].) That fact aside, APS has repeatedly made it clear that the primary reasons for now favoring an inter-company loan over the guarantee (if it is forced to choose one over the other) are: (i) the complexity and resulting timing of implementing a guarantee are critical in light of the timing of the anticipated Commission order and the bridge debt coming due; and (ii) the guarantee cannot be implemented with all of Staff's conditions in place, not because it might be slightly easier to undo a loan than a guarantee.

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Panda/TECO also argues that a Commission decision approving a loan instead of a guarantee will "decimate" or "devastate" wholesale competition, basing that conclusion on the illogical assumption that PWEC would default on the loan simply to transfer the PWEC assets over to APS. Panda/TECO simply disregard the clear testimony regarding the numerous reasons why PWEC and PWCC would do everything in their power to avoid such an event. (Tr. vol. I at 81-84 [B. Gomez]; *see also* Tr. vol. I at 67 [C. Kempley].)

In addition, Panda/TECO ignores the fact that if APS wished simply to acquire the PWEC assets without compensating PWEC and without a Commission determination that the rate-basing of these assets was in the long-run best interests of APS customers, it could have done so at any time. And it could have done so without imperiling PWCC's credit by purposely triggering a cross-default, without agreeing to a dividend limitation, without crediting customers with millions of dollars of net interest income, and without all the other conditions imposed by Staff. And the issue of rate base treatment, which is at the center of Panda/TECO objections, is an issue for the Company's 2003-2004 rate proceeding.[7]

3. The Commission Should Reject the Three Conditions Proposed by Panda/TECO

In its Initial Brief, Panda/TECO proposes that in addition to requiring APS to guarantee the debt of PWEC, the Commission should impose three "critical" conditions on that guarantee. (Panda/TECO Brief at 32-34.) The Commission should reject each of those proposed conditions as impractical, unnecessary and contrary to APS customers' best interests. While those conditions might allow Panda/TECO to support the guarantee option, they would (i) eviscerate Staff's proposed conditions; (ii) render the proposed

[7] Panda/TECO places a great deal of reliance on an argument challenging the cross-default risk pointed out by APS to counter the speculation that PWEC would simply default on the loan. But contrary to the Panda/TECO implication, if PWEC were to default on the APS loan, $450 million of PWCC bank debt would immediately cross-default. (Tr. vol. II at 326-327 [B. Gomez].)

guarantee unmarketable; and (iii) put APS, and therefore its customers, at greater and unnecessary risk.

Panda/TECO first proposes that the PWEC assets should be pledged to a third-party lender instead of to APS. (Panda/TECO Brief at 32.) That proposal directly conflicts with Staff Proposed Condition No. 2, which Staff testified was put in place specifically to protect APS and its customers. (Staff's Initial Brief at 5; Tr. vol. IV at 935 [J. Thornton].)

Panda/TECO further proposes that the Commission require a third-party lender to execute on the PWEC assets before seeking payment from APS on the guarantee in the event of default. (Panda/TECO Brief at 33.) APS has already addressed the remoteness of such an event, but even if a default occurred, imposing such a requirement simply would render the financing unmarketable—no lender would rationally consent to having its remedies limited in such a manner. Instead, a lender would require that it have the option to elect whichever remedy it wanted.

Finally, Panda/TECO proposes that APS be precluded from bidding on the PWEC assets if PWEC defaults, thus triggering an auction. (Panda/TECO Brief at 33-34.) This last proposed condition clearly places APS and its customers unnecessarily at risk and would impose a condition simply unheard of in the secured financing market. It would be imprudent, to say the least, for a secured creditor, which APS would be, to preclude itself from bidding on any assets in which it held a sizeable security interest. It is a fundamental principle of commercial secured transactions that a creditor is entitled to protect its own equity in an investment by bidding at least its secured amount into any auction. Panda/TECO's proposed condition could also preclude the Commission from ever considering the used and usefulness of plants that have already provided invaluable service to APS customers.

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III. REPLY TO SEMPRA/SOUTHWESTERN

In their brief, Sempra/Southwestern argue that APS did not establish that the proposed financing met the statutory criteria under A.R.S. § 40-301. These intervenors argue that APS was required to support the statutory findings, several of which are purely legal issues rather than evidentiary in nature, by "clear and convincing evidence." But they fail to cite any authority for the novel proposition that the applicable evidentiary standard for even the required factual findings is that of "clear and convincing evidence." (*See* Sempra/Southwestern Brief at 5.) In fact, the burden of proof in civil cases is satisfied by the preponderance of the evidence. *Goodwin v. Farmers Ins. Co.*, 129 Ariz. 416, 418, 631 P.2d 571, 573 (Ct. App. 1981). The judicial standard for upholding Commission determinations is that of substantial evidence, an even lower degree of proof. *Tucson Electric Power Company v. Arizona Corporation Commission*, 132 Ariz. 240, 645 P.2d 231 (1982). And having first misstated the proper evidentiary standard, Sempra/Southwestern proceed then to misapply their own standard to each element required under the statute.

First, Sempra/Southwestern make the implausible argument that APS' Articles of Incorporation[8] do not provide APS with the corporate power to conduct the financing. APS' current Articles of Incorporation were adopted in 1988 under Title 10 of the Arizona Revised Statutes (the "1976 Arizona Business Corporation Act"). A provision of that 1976 Act, A.R.S. §10-054(A)(4), required all corporations to include in their articles of incorporation "[a] brief statement of the character of business which the corporation initially intends actually to conduct in this state." That statute further provided that "[s]uch statement shall not limit the character of business which the corporation ultimately

[8] The Chief Administrative Law Judge took administrative notice of APS' Articles of Incorporation. (Tr. vol. II at 452.)

conducts."[9] (Emphasis added.) This is, of course, a necessary result because Sempra/Southwestern's unreasonable interpretation to the contrary would prohibit public service corporations such as APS from, for example, contributing to charities, operating an employee cafeteria or even providing vending machines for its employees.

Under the 1976 Arizona Business Corporation Act, A.R.S. §10-003 provided that corporations may be organized "for any lawful purpose or purposes not specifically prohibited to corporations under the laws of this state." In addition, A.R.S. §10-004 of the 1976 Arizona Business Corporation Act gave corporations the power to pledge property, make contracts, incur liabilities, borrow and lend money, and issue notes, bonds and other obligations, while also providing that "unless so denied, limited or otherwise reduced the powers enumerated in this section are to be construed broadly." (Emphasis added.) Today, A.R.S. § 10-302 provides for most of the same corporate powers—the power to pledge property, make contracts, incur liabilities, borrow and lend monies, and issue notes, bonds or other obligations. Additionally, A.R.S. § 10-301 provides that "[s]ubject to any limitations or requirements contained in the articles of incorporation or in any other applicable law, a corporation shall have the purpose of engaging in and may engage in any lawful activity." Accordingly, the language included in APS' Articles of Incorporation to comply with the then-applicable 1976 Arizona Business Corporation Act did not, as a matter of law, act as an implied limitation to the broad "purposes" paragraph of those Articles discussed in the Company's Opening Brief.

Next, although they presented no witnesses and filed no testimony in this proceeding, Sempra/Southwestern argued that the proposed financing is not compatible

[9] Although the 1976 Arizona Business Corporation Act was revised by the Arizona legislature in 1996, the current provisions regarding this issue are essentially the same. A.R.S. §10-202(A)(3) requires all corporations to provide in their articles of incorporation, "[a] brief statement of the character of business that the corporation initially intends to actually conduct in this state," but also provides that "[t]his statement does not constitute a limitation on the character of business that the corporation ultimately may conduct."

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with the public interest or with sound financial practices. (Sempra/Southwestern Brief at 8-10.) They ignore the expert testimony of APS witnesses that PWCC would be downgraded if the financing is not approved, and that this downgrading would adversely affect APS, (*see* APS' Initial Brief at Sections IV.A and IV.B), choosing to mischaracterize such evidence as "conjecture" and not "actual proof." Apparently, the only "actual proof" acceptable to Sempra/Southwestern would be for the downgrades of PWCC and APS to first occur, at which point it would be too late to avoid and much more costly to repair the damage. (*See* Tr. vol. III at 774 [S. Abbott].) They also ignore the evidence that approval of the application will not adversely affect APS.[10] (*See* APS Opening Brief at Section IV.C.)

These two intervenors also choose to ignore the significant conditions recommended by Staff and agreed to by APS, (*see id.* at Section VII), as well as the impact of Decision No. 65154, incorrectly calling the financing "gratuitous financial support." And, nowhere does Sempra/Southwestern actually explain how approving the proposed financing would "undercut or dilute" the wholesale market in Arizona or how such approval results in "undercutting or prepositioning" the issue of rate-basing the PWEC assets. (*See* Sempra/Southwestern Brief at 9-10.) To the contrary, denying the application will likely foreclose the ability of the Commission to decide on the ratebasing issue, as it may require the disposal or encumbering of the PWEC assets—a result that Sempra/Southwestern might prefer, but hardly a good policy outcome for the Commission or for APS customers. (*See* APS Opening Brief at Section V.D.) Sempra/Southwestern have presented no argument to contradict APS' and Staff's evidence that the proposed financing is in the public interest and compatible with sound financial practices.

[10] Again without citation to any authority of any kind, Sempra/Southwestern argues that APS burden should be "higher" than the clear and convincing evidence standard in this "gray area." Of course, there is no justification for imposing what would amount to a near impossible-to-meet "beyond a reasonable doubt" standard in utility financing cases.

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In their final assault on the proposed financing, Sempra/Southwestern posit yet another standard of proof—that APS must "affirmatively demonstrate, with credible evidence, that the [proposed financing] has a direct bearing upon its ability to [provide electric service]." (Sempra/Southwestern Brief at 12.) Again, we are provided absolutely no authority (case law, prior Commission ruling, statutory construction, or legislative history) for this proposition. APS and Staff presented ample evidence that the proposed financing was compatible with and in furtherance of APS' obligations as a public service corporation. (APS Opening Brief at Section VI.E; Tr. vol. IV at 1000 [J. Thornton].) APS also presented substantial evidence that the proposed financing would not adversely impact APS and that APS would be able to continue to discharge its obligation to serve. (APS Opening Brief at Section IV.C and Section VI.E.) Simply dismissing sworn expert testimony and other evidence as "conjecture and innuendo" (Sempra/Southwestern Brief at 12) is not enough to overcome the evidence that is in the record supporting the proposed financing. Indeed, Sempra/Southwestern themselves state that "[a]ny negative impact on APS' credit is significant"—a statement that clearly supports APS' efforts to protect against such impacts by seeking approval for the proposed financing. (*See id.* at 12-13.) Ultimately, none of Sempra/Southwestern's arguments have the slightest merit and should be rejected.

IV. REPLY TO STAFF AND RUCO

A. Staff

APS strongly agrees with Staff's Initial Brief in both its ultimate conclusions and recommendations and also in its excellent analysis of the Panda/TECO positions. There are, however, three secondary issues in Staff's Brief that require a response and some clarification.

First, there is the concern about APS having sufficient unutilized debt capacity for

its other needs. (Staff Initial Brief at 4.) This potential concern was addressed by APS witness Barbara Gomez in her Rebuttal Testimony at page 10, and Mr. Thornton took no issue with that rebuttal in his oral surrebuttal. (*See* Tr. vol. IV at 902-908 [J. Thornton].)

Second, the Staff Brief states that "PWCC and PWEC are benefiting tremendously from this transaction." (Staff Initial Brief at 5.) This is simply not the case. Both entities will still be substantially worse off than before Decision No. 65154. (B. Gomez Direct Test. at 5.) In fact, PWCC receives no economic benefit from the Application. Its equity investors will still bear the full economic brunt of the Commission's change in direction, at least until the remaining issues described in the Principles for Resolution are addressed in the next APS rate proceeding.

Staff's Brief further contends that the Application, without Staff's conditions, "will expose APS to risk without providing its customers with any extra benefits commensurate to that risk." (Staff Initial Brief at 5.) All actions carry some risk, as do failures to act. Failing to act in this instance would have exposed APS customers to far more risk than that posed by the Application. (B. Gomez Direct Test. at 5.) Moreover, the Brief's statement does not appear to acknowledge the impact of Staff's own recommended conditions, which conditions have, in virtually every respect, been adopted by the Company.

B. RUCO

APS appreciates RUCO's support of the Application. But the Company does not believe that it would be appropriate for the Commission to require a proceeding seeking the transfer of the PWEC assets to APS at this time. The Commission must be given adequate opportunity to consider APS' future request for rate-basing those assets. If the Commission ultimately decides that APS may rate-base the PWEC assets, PWEC will necessarily transfer the assets to APS, thus mooting RUCO's concerns. If the Commission instead determines that APS should not rate-base some or all of the PWEC assets, it may

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be better to leave those assets at PWEC rather than put APS into the competitive merchant generation business. Moreover, any attempt to transfer the PWEC assets to APS would be very contentious. Staff's Condition No. 2 provides essentially the same protection of APS' interests without raising the heightened concerns and additional litigation risk that a request to transfer the assets would raise. (Tr. vol. II at 263 [B. Gomez].)

V. REPLY TO RELIANT AND AECC

A. AECC

In their Post-Hearing Opening Brief, the AECC did not oppose Commission approval of the proposed financing. Instead, the AECC argued solely that a decision should specifically reject certain portions of the Principles of Resolution agreed to by Staff and the Company because AECC believes them contrary to the 1999 APS Settlement. The AECC has never informed the Company that it believed any or all of the Company's restitution claims violated the 1999 agreement, even though such notice is itself required under the Settlement. And although also bound by the agreement to support the Settlement, the AECC submitted testimony opposing divestiture in Track A. Yet it now apparently asserts that APS cannot even request relief from the Commission on any aspect of the 1999 Settlement Agreement that APS has already performed.

In any event, the Commission need not address AECC's apparent inconsistency in this proceeding. Contrary to the arguments in the AECC's Post-Hearing Opening Brief, the Principles of Resolution are an agreement solely between Staff and the Company—not the Commission—and do not prejudge the ultimate resolution of the issues discussed by AECC. (*See, e.g.,* Tr. vol. II at 441-42 [J. Davis].) And APS can certainly withdraw portions of its pending Track A appeal on its own motion, with or without Commission action, particularly if approval of the financing application mitigates some of APS' damage claims. Indeed, it is APS, and not Staff that will take affirmative action in the

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Track A appeals, thus distinguishing *Johnson v. Tempe School Board*, 199 Ariz. 567, 20 P.3d 1148 (Ct. App. 2000).

B. Reliant

In it's opening brief, Reliant states that it takes no position on whether the Commission should approve APS' Application, but instead argues only that the Commission should "expressly prohibit prejudice to the Track B solicitation or any ratebasing of PWEC generation assets." (Reliant Initial Brief at 3.) Reliant focuses its concern on two alleged issues: (i) whether the approval of the Application will prejudice the Commission's ultimate decision on whether to rate base the PWEC assets; and (ii) whether PWEC will gain any advantage in meeting the creditworthiness requirements for participating in the bidding process.

As Reliant acknowledges, APS has repeatedly stated that the approval of the Application will not prejudice the Track B solicitation process anticipated to begin in March. (*Id.*) Approval of the Application will, however, permit PWEC to compete fairly in the solicitation. Under the Commission's own rules, APS is required to request Commission approval before being permitted to rate base any asset. In light of that requirement, APS does not believe that the Commission needs to expressly declare that it will not be prejudiced by the approval of the Application.

As a participant in the Track B process, PWEC will be required to meet the same credit requirements as any other bidder. Contrary to Reliant's assertion, however, the granting of the Application does not provide PWEC any advantage in meeting the credit requirements because PWEC will remain without an investment grade credit rating. Instead, granting the Application, in conjunction with other actions initiated by PWCC, will simply help to maintain the investment grade credit rating that PWCC currently has and which PWEC would have had if the assets had been transferred.

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VI. CONCLUSION

Every party to this matter that has any legal responsibility to represent the interests of APS customers, APS investors, or the public interest either supports the Company's Application, or in the case of AECC, does not oppose the Application. With Staff's proposed seven conditions, even as modified and clarified per the Company's testimony, the Application provides APS consumers both complete protection and substantial benefits. Panda/TECO's proposals offer neither. The Commission's approval of the Application will also result in resolving several of the issues left over from Track A and will create a framework for addressing the remaining issues raised by that decision in the Company's next general rate proceeding. APS urges the Commission to seize this unique opportunity and approve the Company's request subject to the conditions recommended by Staff and supported by APS.

RESPECTFULLY SUBMITTED this 6th day of February 2003.

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